Target (TGT)

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Disclaimers

• I am not a registered investment advisor and I do not offer any investment advise

• No parts of this talk are suggestions to invest, not invest, buy or sell any kind of securities or other financial instruments
Target - business

- Target Corporation operates general merchandise stores in the United States
  - Food
- 1,750 stores
- Target.com
- Credit cards - being sold
Target - business (cont’d)

- Competition:
  - WalMart
  - Costco
  - Etc.
Target - Misc thoughts

• What can go wrong?
  • Rising commodity prices potentially squeezing margins and low cost sales
• Opportunities:
Strategic considerations

- Moat (*switching costs, habit, low cost*):
  - What are the moats? Not much. Close to low cost stores
  - What does it take to sustain the moats? Providing merchandise at low(est) cost with good shopping experience

- Is it a low risk business? Somewhat.
- Is there high uncertainty? Not very
- How capital intensive is the business? Shops
- Future growth - saturation?
- Are the revenues and cash flows of the business sustainable or overstated / understated due to boom or bust conditions? Probably not
Management

- I don’t usually do management analysis. Included for template completeness
- No dilution
- Can I trust management?
- Management shareholding (> 10%)
- Management incentives?
- Are the salaries too high?
- Is there heavy insider buying?
- Is there heavy insider selling?
- Do I like the management? (Operators, capital allocators, integrity)
- Profitable reinvestment
- What has management done with the cash?
- Where is Free Cash Flow invested? Share buybacks, dividends, reinvested, ROE & ROCE, incremental BV
Piotroski Score

Only applicable to Graham Cos - N/A to TGT

1. Net Income: Bottom line. Score 1 if last year net income is positive.

2. Operating Cash Flow: Better earnings gauge. Score 1 if last year cash flow is positive.

3. Return On Assets: Measures Profitability. Score 1 if last year ROA exceeds prior-year ROA.

4. Quality of Earnings: Warns of Accounting Tricks. Score 1 if last year operating cash flow exceeds net income.

5. Long-Term Debt vs. Assets: Is Debt decreasing? Score 1 if the ratio of long-term debt to assets is down from the year-ago value. (If LTD is zero but assets are increasing, score 1 anyway.)

6. Current Ratio: Measures increasing working capital. Score 1 if CR has increased from the prior year.

7. Shares Outstanding: A Measure of potential dilution. Score 1 if the number of shares outstanding is no greater than the year-ago figure.

8. Gross Margin: A measure of improving competitive position. Score 1 if full-year GM exceeds the prior-year GM.

9. Asset Turnover: Measures productivity. Score 1 if the percentage increase in sales exceeds the percentage increase in total assets.

• Total: / 9
Is it a good business?

- >10 year history of profits
- **ROE:**
- **Margins**
  - 2009: 3.4  2010: 3.8  2011: 4.3
- **Growing earnings:** 3 year sales growth 2%, earnings growth 1%
- No dilution
- **Weak balance sheet**
  - Debt >> cash/short term investments
- **ROIC = Earnings / (Equity + Debt - Cash) = Earnings / (Assets - non-debt liabilities - Cash)**
  - 10% ROIC
Is it a good business? Cash flow

• Strong operating cash flow and FCF:
  • 2011 2.9B earnings, 5.3B operating cash flow, 3.1B FCF (FCF = OCF - capital expenditures)
  • Free Cash Flow/Share higher than dividends paid
Is business cheap? - Buffettology calculations

- ROE 15% (but ROIC 10%)
- Earnings in 10 years = ROE*Equity*(1+ROE)^9 = $8B
- Equity in 10 years = Equity*(1+ROE)^9 = $5.35B
- Market cap = 25B x P/E (15) = $120B
- Rate of return = 12% after tax (calculations omitted), only 4.5% at 10% ROIC

- 9 year earnings growth: 12%. Assuming 12% earnings growth: 15% share price growth.
Is business cheap? DCF

- Discounted cash flow
  - Current earnings of 2.9B
  - 5% growth for 5 years, leveling after that
    - 15% discount -> $23.4B current valuation (if you buy company at <$23.4B, you will get 15% return or higher)
  - 5% growth for 10 years, leveling after that
    - 15% discount -> $26B current valuation
  - 10% growth for 10 years, leveling after that
    - 15% discount -> $35B current valuation
- Owner’s yield = earnings / (market cap + debt - cash) = earnings/EV
  - 2.9B / (32B+14B) = 6.3%
- What makes up the margin of safety? Low cost leader
- Is there a sufficient margin of safety? No
Is business cheap? - Graham investment considerations

• N/A for TGT - included for completeness
• 2 P/Book - not a net net
• Altman Z score (http://en.wikipedia.org/wiki/Altman_Z-score)